Surveys of Consumers

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Consumer Confidence Cools: When Bad News Is Good

Index Continues to Slip

The Index of Consumer Sentiment was 91.5 in the April 1989 survey, down from 94.3 in March. This marks the third consecutive monthly decline, reversing the entire 6 Index-point gain recorded in January. While this represents a significant loss from the 97.9 recorded in January, the April 1989 figure remains comparable to the 91.9 recorded in December and the 91.2 recorded in April 1988.

While the recent decline in consumer confidence has been modest, it has eased demand pressures on the economy. Rising interest rates have made consumers much more cautious in their spending plans, but thus far those increases have not caused consumers to become pessimistic about their own financial prospects or those for the economy as a whole. In this manner, the downward drift in consumer confidence will reduce the need for further interest rate increases, and help extend the length of the current expansion.

Among families with incomes of $30,000 or more, the Index slipped to 99.8 in April 1989, barely below the 100.0 recorded in March, but significantly below the 106.8 recorded at the start of the year.

Leading Indicator Falls

The entire loss recorded in the April survey was in the expectations component of the Index, not in evaluations of current economic conditions. The Index of Consumer Expectations, the component of the Leading Indicators Index, fell to 83.2 in April from 87.6 in March and 89.9 at the start of the year. The largest declines in the April survey were recorded in prospects for the general economy. Personal financial expectations for the year ahead remained largely unchanged.

In contrast, the Current Conditions Index was 104.4 in April, barely below the 104.8 recorded in March. Evaluations of buying conditions for large household durables posted a slight gain, and was offset by a slight loss in consumers' evaluations of their current financial situation.

Prospects for Economy Soften

Consumers' evaluations of the current state of overall business conditions have declined since the start of the year. In the April 1989 survey, 41 percent thought that current economic conditions had improved over those of a year earlier, down from 47 percent in March and 53 percent in January. At present, the proportion of families who thought business conditions had improved during

the past year was barely higher than those who thought they had worsened (41 versus 39 percent).

The majority of families in the April 1989 survey (57 percent) expected business conditions in the country as a whole to remain largely unchanged during the year ahead. Among those that expected change, opinions were nearly equally divided between those that expected improvements and those that expected declines (20 versus 21 percent).

For the country as a whole, good times financially were expected by 49 percent of all families in the April 1989 survey, although significantly below the 55 percent recorded one month earlier, it was only marginally below the 50 percent recorded a year earlier.

Prospects for the economy over the longer term also declined in the April 1989 survey. Like the short term outlook, the recent decline has returned longer term prospects to a level comparable to the year earlier reading. Among all families in the April 1989 survey, 37 percent expected good times financially over the next five years, down from 40 percent in March, but just above the 36 percent recorded in April 1988 survey. At present, more families expected bad rather than good times financially over the longer term by the margin of 46 to 37 percent.

Low Unemployment Rate Remains Central Strength

The majority of families in the April 1989 survey (55 percent), expected the national unemployment rate to remain largely unchanged at it current low level during the year ahead. Given the current record low level of the national unemployment rate, this is certainly a positive expectation, and has helped to maintain expectations for personal finances at favorable levels.

On the margin, however, more families in the April 1989 survey expected the national unemployment rate to increase than to decline by the margin of 29 to 14 percent. Given the length of the current expansion and the current low unemployment rate, this expectation indicates that consumers think the unemployment rate has already reached its cyclical lowpoint.

Inflation Fears Ease

The annual rate of inflation expected by consumers eased to 5.0% in the April 1989 survey, down from 5.6% in March. The April decline returns inflation expectations to the level recorded at the beginning of the year. Although inflation expectations have eased from the drought induced increases recorded in mid 1988, they still remain above the prior trend--above the 4.5% recorded one year earlier and the 3.7% recorded two years earlier.

Interest Rates Increases Remain Top Concern

Interest rates were expected to increase by 75 percent of all families in the April 1989 survey, equal to the all-time record high first recorded in February 1989. Just 7 percent of all families expected interest rates to decline during the year ahead. Concerns with rising interest rates have not only made consumers more cautious about the used of credit, it has also increased the appeal of adding to savings and reserve funds.

Home Buying Attitudes Continue to Weaken

Rising mortgage interest rates continued to dampen favorable attitudes toward home buying conditions. In the April 1989 survey, 58 percent thought that home buying conditions were favorable, down from 60 percent one month earlier, 72 percent one year earlier, and 82 percent two years earlier. Home buying attitudes are now at their lowest level recorded during the last four years.

When asked to explain their opinions about buying conditions for homes, the proportion that

mentioned that mortgage interest rates were too high and a cause for postponement rose to 28 percent in April, up from 24 percent one month earlier and just 10 percent one year earlier.

Because further increases in mortgage rates are still expected, the negative impact of the recent increases continue to be partially offset by the view that it would be better to borrow in advance of those rising rates. Among all families in the April survey, 20 percent mentioned this rationale, unchanged from one and two months earlier, but twice the level recorded one year earlier.

Favorable references to the current level of mortgage rates fell to 16 percent in the April 1989 survey from 40 percent one year earlier.

Vehicle Buying Attitudes Helped by Discounts

Unlike buying conditions for homes, vehicle manufacturers have been able to shield new vehicle sales from the adverse impact of increases in market interest rates. The recent round of discounts offered by vehicle manufacturers has improved buying attitudes. Among all families in the April 1989 survey, 65 percent held favorable vehicle buying attitudes, up from the 61 percent recorded in the prior two months.

Compared with a month earlier, more families mentioned the availability of interest rate discounts in the April survey (25, up from 15 percent), and more families mentioned the availability of price discounts (32, up from 27 percent).

Personal Finances

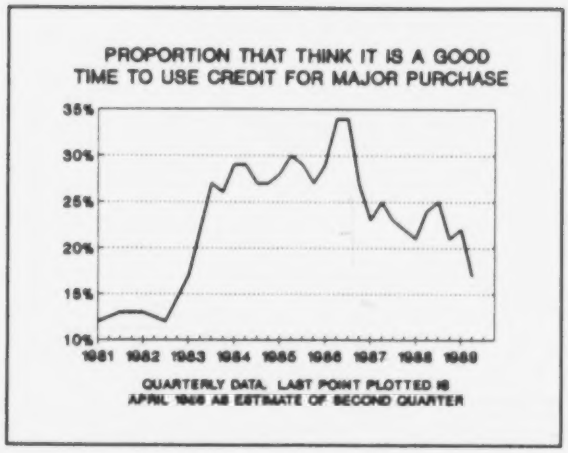
An improved financial situation was reported by 42 percent of all families in the April 1989 survey, unchanged from one month and one year earlier. The change that has occurred during the past year has been a small increase in the proportion of families that thought their financial situation had worsened, while fewer families judged their finances to have remained unchanged. The proportion of consumers that thought their current financial situation had worsened rose to 29 percent in April 1989, above the 26 percent recorded one month earlier and the 24 percent recorded one year earlier.

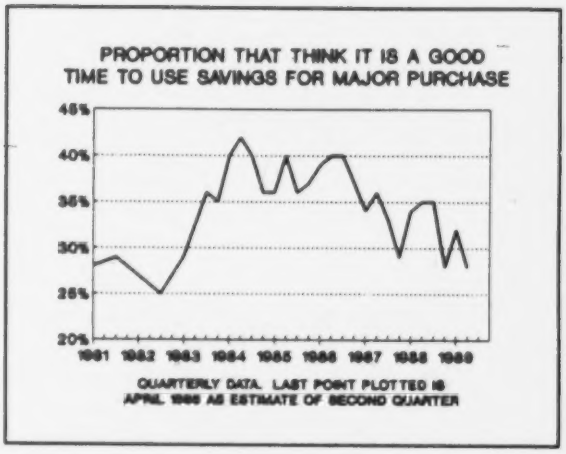
The maintenance of positive assessments of their current financial situation has been due to continued widespread reports of income gains; rising prices, however, have eroded some of these gains. Compared with a year earlier, more families reported income gains in April 1989 (36 versus 30 percent), but more families also reported declines in the purchasing power of their incomes due to rising prices (16 versus 9 percent).

Despite these rising concerns with the impact of inflation on family budgets, consumers continue to view prospects for the year ahead in favorable terms. Among all families in the April 1989 survey, 41 percent expected their financial situation to improve during the year ahead, up from 40 percent in March and 34 percent in April 1988. Indeed, whereas consumer evaluations of their current financial situation are now at the lower end of the horizontal zig-zag path traced during this long expansion, financial expectations remain at the upper end.

Cautious Spending Plans

When asked whether they were reluctant to take on new debt or use accumulated savings to make large purchases, consumers have indicated a consistent rise in cautious spending plans during the past few years (see the Figures on the next page). Among all families in the April 1989 survey, 17 percent reported that they were not reluctant to buy on credit, down from 22 percent in March, and only half the level recorded at the 1986 peak.


PROPORTION THAT THINK IT IS A GOOD TIME TO USE CREDIT FOR MAJOR PURCHASE
35%
30%
25%
20%
15%
10%
1981 1982 1983 1984 1985 1986 1987 1988 1989
QUARTERLY DATA. LAST POINT PLOTTED IS APRIL 1989 AS ESTIMATE OF SECOND QUARTER


PROPORTION THAT THINK IT IS A GOOD TIME TO USE SAVINGS FOR MAJOR PURCHASE
45%
40%
35%
30%
25%
20%
1981 1982 1983 1984 1985 1986 1987 1988 1989
QUARTERLY DATA. LAST POINT PLOTTED IS APRIL 1989 AS ESTIMATE OF SECOND QUARTER

Willingness to use some of their accumulated savings in order to make a large purchase has also declined. In the April 1989 survey, 28 percent reported that they were not reluctant to use savings to make major purchases, down from 32 percent in March, and 40 percent in 1986.

Why the greater caution in spending plans given the maintenance of favorable personal financial prospects? Rising interest rates have meant that debt has become less attractive and savings more attractive. The rate of savings out of disposable income has increased in recent months, rising to just over 6% in March.

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The April 1989 survey included 500 completed interviews conducted between April 1 and April 28, 1989.